



BILLING CODE: 8025-01

U.S. SMALL BUSINESS ADMINISTRATION

13 CFR Parts 115, 120, and 121

RIN: 3245-AG73

Affiliation for Business Loan Programs and Surety Bond Guarantee Program

AGENCY: Small Business Administration.

ACTION: Proposed Rule.

SUMMARY: The U.S. Small Business Administration (SBA) has determined that changing conditions in the American economy and a constantly evolving small business community compel it to seek ways to improve program efficiency for its Surety Bond Guarantee (“SBG”) Program, and the business loan programs consisting of the 7(a) Loan Program, the Business Disaster Loan Programs (collectively, the Economic Injury Disaster Loans, Reservist Injury Disaster Loans, Physical Disaster Business Loans, Immediate Disaster Assistance Program loans), the Microloan Program, and the Development Company Program (the “504 Loan Program”). As a result, SBA proposes to simplify guidelines for determining affiliation for eligibility based on size as it relates to these programs. This proposed rule would redefine affiliation for all five Programs, thereby simplifying eligibility determinations.

DATE: SBA must receive comments to the proposed rule on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN: 3245-AG73 by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: [ocareg2015@sba.gov](mailto:ocareg2015@sba.gov). Include RIN 3245-AG73 in the subject line of the message.
- Mail: Linda Reilly, Chief, 504 Loan Program, Office of Financial Assistance, Office of Capital Access, Small Business Administration, 409 Third Street SW, Washington, DC 20416.
- Hand Delivery/Courier: Linda Reilly, Chief, 504 Loan Program, Office of Financial Assistance, Office of Capital Access, Small Business Administration, 409 Third Street SW, Washington, DC 20416.

SBA will post all comments on [www.regulations.gov](http://www.regulations.gov). If you wish to submit confidential business information (CBI) as defined in the User Notice at [www.regulations.gov](http://www.regulations.gov), please submit the information to Linda Reilly, Chief, 504 Loan Program, Office of Financial Assistance, Office of Capital Access, 409 Third Street SW, Washington, DC 20416, or send an email to [ocareg2015@sba.gov](mailto:ocareg2015@sba.gov). Highlight the information that you consider to be CBI and explain why you believe SBA should hold this information as confidential.

SBA will review the information and make the final determination whether it will publish the information.

FOR FURTHER INFORMATION CONTACT: Linda Reilly, Chief, 504 Loan Program, Office of Financial Assistance, Office of Capital Access, Small Business Administration, 409 Third Street SW, Washington, DC 20416; telephone 202-205-9949.

## SUPPLEMENTARY INFORMATION:

### I. Background

Executive Order 13563, “Improving Regulation and Regulatory Review,” provides that agencies “must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends.” (Emphasis added). Executive Order 13563 further provides that “[t]o facilitate the periodic review of existing significant regulations, agencies shall consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned.” (Emphasis added). SBA has reviewed its regulations with regard to the business loan programs and SBG program and is proposing a number of amendments and revisions to accomplish this goal.

The business loan programs authorized by the Small Business Act (Act), 15 U.S.C. 631 et seq., that are affected by this proposed rule are: (1) the 7(a) Loan Program authorized by Section 7(a) of the Act; (2) the Business Disaster Loan Program (“BDLP”) Program authorized by Section 7(b) of the Act; and (3) the Microloan Program authorized by Section 7(m) of the Act. The 504 Loan Program, which is authorized by Title V of the Small Business Investment Act of 1958 (the “SBIA”), as amended, 15 U.S.C. 695 et seq., is also affected. These programs (7(a), BDLP, Microloan, and 504) are referred to collectively as the Business Loan Programs in this rule. Finally, this rule also proposes revisions to the Surety Bond Guarantee (“SBG”) Program, authorized by section 411 of the SBIA. A description of each program is set forth below.

#### A. 7(a) Loan Program

The 7(a) Loan Program's main purpose is to help eligible small businesses obtain credit when they cannot obtain credit elsewhere. The Agency recognizes that the 7(a) Loan Program is an important engine for job creation. The 7(a) Loan Program provides financing for general business purposes through the guaranty of loans made by participating private sector lenders. Currently, there are approximately 4,500 lenders participating in the 7(a) Loan Program with approximately \$66 billion in total SBA guarantees outstanding.

#### B. Business Disaster Loan Programs

Through its Business Disaster Loan Programs, SBA provides low-interest disaster loans to businesses of all sizes and private non-profit organizations. These loans can be used to restore, repair or replace disaster damaged assets and working capital as a result of a declared disaster. The loans are made directly by SBA and repayment terms are determined on a case-by-case basis, based upon each borrower's satisfactory credit and ability to repay.

#### C. Microloan Program

The Microloan Program provides loans up to \$50,000 to help small businesses and certain nonprofit childcare centers. The average microloan is about \$13,000. SBA lends funds to specially-designated intermediary lenders, which are primarily nonprofit community-based organizations with experience in lending as well as management and technical assistance. These intermediaries administer the Microloan Program for eligible borrowers lending directly to them. Each intermediary lender has its own lending and credit requirements. Intermediaries generally require some type of collateral as well as the personal guarantee of the business owner. Depending on their prior experience,

applicants to the Microloan Program may be required to fulfill training or planning requirements before a loan application will be considered.

#### D. 504 Loan Program

The core mission of the 504 Loan Program is to provide long-term fixed asset financing to small businesses for the purchase or improvement of land, buildings, and major equipment purchases, to facilitate the creation of jobs and to stimulate local economic development. A Certified Development Company (“CDC”) is a nonprofit corporation, with the exception of selected for-profit CDCs grandfathered into the 504 Loan Program that promotes economic development within its community through 504 loans. Under the 504 Loan Program, loans are made to small business applicants by CDCs, which are funded through sales of debentures, which are guaranteed 100% by the SBA. There are over 260 CDCs nationwide, each with a defined Area of Operations covering a specific geographic area.

#### E. SBG Program

Pursuant to the SBG Program, SBA guarantees bid, payment and performance bonds for small and emerging contractors who cannot obtain surety bonds through regular commercial channels. SBA's guarantee is an agreement between a Surety and SBA that SBA will cover a certain percentage of the Surety's loss should a contractor default on the underlying contract. Specifically, SBA guarantees Sureties participating in the program against a portion of their losses incurred and paid as a result of a breach of the terms of a bid bond, final bond or ancillary bond, on any eligible contract. SBA's guarantee gives Sureties an incentive to provide bonding for small businesses and thereby assists small

businesses in obtaining greater access to contracting opportunities which require these bonds as a condition for obtaining the contract.

## II. Summary of Proposed Program Changes

The Agency, in compliance with Executive Order 13132, previously requested and received public comments on the Rules of Affiliation as part of a Notice of Proposed Rule Change (February 25, 2013) to update the business loan program. SBA received and reviewed comments and met with industry participants to identify best practices based on the feedback. SBA received 54 comments regarding Affiliation Rules in general support of the proposed change. Ten comments further suggested modification and clarification of the proposal. The most consistent concern expressed was the need in that proposal to require a borrower to prepare a document that qualified each potential affiliation under SBA rules. SBA has determined that the modifications proposed herein fully incorporate previous input.

Below is a summary of the proposed changes regarding determining size and affiliation of applicants to Business Loan Programs and SBG Programs. The Agency requests comments on all of the proposed regulatory revisions in this rule and on any related issues affecting the programs.

### A. Business Loan Programs and Affiliation

The Act defines a small business concern as “one which is independently owned and operated and which is not dominant in its field of operation...” 15 U.S.C. 632(a)(1). In order to be eligible for an SBA guaranteed loan, an applicant must be a small business pursuant to size standards established by SBA through regulation. 13 CFR 120.100. In general, to be considered small, concerns must meet the particular size standard that

corresponds to a six-digit North American Industrial Classification System (NAICS) code. Each size standard is stated in terms of either gross revenue receipts or number of employees, and in limited cases a basis other than receipts or employees (e.g., megawatt hours). SBA considers the receipts or employees (or other measure) of an applicant, and all of its domestic and foreign affiliates, when determining a business concern's eligibility as a small business. 13 CFR 121.103(a)(6).

SBA's regulations in 13 CFR 121.103 set forth the Agency's principles of affiliation and explain when an individual or an entity is an affiliate of another individual or entity. SBA's affiliation rules generally apply to all SBA programs for which a business must qualify as small, including SBA's government contracting and business development programs, small business loan programs and grant programs. Generally, affiliation exists when one business controls or has the power to control another or when a third party (or parties) controls or has the power to control both businesses. Control may arise through ownership, management, or other relationships or interactions between parties. SBA may also find affiliation based on "negative control," which includes instances where a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

Upon review of the statutory provisions for the Business Loan Programs, the purpose behind these programs, and the overall goals of simplification and maximization of benefits for small businesses, SBA is proposing amendments to the current affiliation rules with respect to these programs. SBA believes that, in general, a majority of the principles of affiliation set forth in §121.103 apply to the Business Loan Programs.

However, SBA believes that certain affiliation principles in their current form are more applicable to determining size with respect to federal contracting and subcontracting (where SBA is trying to ensure only eligible small businesses win federal contracts expressly intended for small businesses) and are not necessarily applicable to business loan applicants. SBA seeks to create simple, bright-line tests for Business Loan Program applicants when determining eligibility with respect to size and affiliation, and streamline requirements for determining whether a business is small for purposes of receiving SBA loan assistance. In addition to clarification, this will reduce costs of an application for the loan applicant and its participating lender.

SBA previously amended the affiliation rules for the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs. Small Business Size Regulations, Small Business Innovation Research (SBIR) Program and Small Business Technology Transfer (STTR) Program, Proposed Rule 77 FR 28520 (May 15, 2012) and Final Rule 77 FR 76215 (December 27, 2012). SBA determined that the general affiliation rules did not apply to the SBIR and STTR programs due to the specialized nature of the program (research and development) and the type of small business that applies for the program (innovative start-ups and research businesses). The amended affiliation rules for the SBIR and STTR programs have helped increase opportunities for small businesses within these programs, reduced burdens for SBIR/STTR eligibility, and streamlined the programs' processes.

SBA is proposing similar changes for the Business Loan Programs. In the SBIR revision R&D costs were cited, as an impediment to program participation. Many start-ups and undercapitalized firms face the same, if not greater, economic challenges. SBA



proposes to add a new §121.103(a)(8) that would explain that the bases for affiliation applicable to SBA's Business Loan Programs will be found at a new §121.301(f). SBA proposes to address size and affiliation for the Business Loan Programs separately in this new §121.301(f), to avoid any confusion with SBA's treatment of affiliation for government contracting programs, business development programs, and other purposes.

In the new §121.301(f), SBA proposes to refine the principles of "affiliation" for the purpose of the Business Loan Programs. Proposed new paragraph (f)(1) sets forth the affiliation principles based on percentage of ownership. With respect to affiliation based on control through ownership, SBA's current affiliation rule (see 13 CFR 121.103(c)) sets forth a minority shareholder standard stating that when no one person owns more than 50% of a company, SBA will find that the person(s) that own(s) directly or indirectly an interest in the business no less than the ownership of the next largest owner(s) is deemed to have control of the small business. In addition, if the ownership of a business concern is widely held and no ownership interest is a large single block of stock as compared to any other, then the Board of Directors and President or Chief Executive Officer are deemed to control the business concern, unless they can present evidence showing otherwise.

SBA's current affiliation rule states that if two or more persons own, control or have the power to control less than 50% of the concern's voting interests, and the interests are equal, or approximately equal in size, and the aggregate of these minority holdings is large as compared with any other holding, SBA presumes these owners have control of the business concern.

For purposes of the Business Loan Programs, however, SBA considers that in all of

these instances, the holdings are so diffused that control would always rest with the small business concern's Board of Directors or management since it is that unit of the organization that is truly running the business.

Therefore, in §121.301(f)(1), SBA proposes that for the business loan programs, SBA will determine control exists based on ownership when:

(1) a person owns or has the power to control more than 50% of the voting equity of a concern; or

(2) if no one person owns or has the power to control more than 50% of the voting equity of the concern, SBA would deem the small business to be controlled by either the President, Chairman of the Board, or Chief Executive Officer (CEO) of the concern (or other officers, managing members, partners, or directors who control the management of the concern).

SBA refers to ownership or equity without designating that it is "stock" ownership because not all business loan applicants are corporations with ownership determined through stock issuance.

In paragraph(f)(2) of §121.301 SBA proposes no changes to the existing principles regarding affiliation arising under stock options, convertible securities, and agreements to merge currently found in §121.103(d).

In §121.301(f)(3), SBA proposes to utilize the same principles of affiliation for common management that are set forth in §121.103. However, SBA has amended the language here to clarify the different types of managers or management.

In §121.301(f)(4), SBA is proposing to use a different affiliation rule concerning "identity of interest," 13 CFR 121.103(f), for the purposes of the Business Loan

Programs and Surety Bond Program. Currently under identity of interest, SBA determines affiliation between individuals or firms when these individuals or firms have identical (or substantially identical) business or economic interests, unless they can demonstrate to SBA otherwise. Family members, persons with common investments, or firms that are economically dependent through contractual (or other) relationships, are among those treated this way. For the Business Loan Programs and the Surety Bond Guarantee Program, SBA proposes to presume that there is an identity of interest only between close relatives as defined in §120.10. SBA proposes to retain this affiliation principle based on the customary understanding that close relatives have an overarching and close alignment of interests and a strong financial incentive to participate in and support family businesses. In the proposed rule, SBA states that it may determine affiliation based on an identity of interest for other reasons. Upon such a determination, the applicant may make a case to rebut the SBA decision.

In §121.301(f)(5), SBA proposes to make one change to the existing language affecting affiliation based on franchise and license agreements currently found in §121.103(i). Under current §121.103(i), SBA must review franchise agreements as they pertain to both the applicant and any affiliates of the applicant. If the applicant has an affiliate that operates under a franchise or license agreement, SBA would be required to review the franchise agreements as it pertains to the affiliate to determine the size of the applicant. Therefore, if the affiliate entity was operating under a franchise agreement that gave the franchisor control over the affiliate franchisee, SBA would determine that the affiliate entity is affiliated with the franchisor. Based on this analysis, when the size of the affiliate entity and the franchisor are combined with the size of the applicant, the

applicant may be considered other than small. The proposed regulation would limit franchise or license agreement reviews to the immediate loan applicant, and not consider other agreements in place with affiliated entities.

The proposed change would revise the first sentence of current §121.103(i) to read as follows: “The restraints imposed on a franchisee or licensee by its franchise or license agreement related to standardized quality, advertising, accounting format and other similar provisions, generally will not be considered in determining whether the franchisor or licensor is affiliated with an applicant franchisee or licensee, provided the applicant franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership.” The revised language would ensure that a review of the applicant only takes into consideration the size of the applicant and its direct affiliate and not the relationship of the affiliate to any franchisor or licensor. With this change, SBA will still have to consider the size of any affiliate entities, but will not be required to examine any franchisor/franchisee relationship of the affiliated entity. The remaining language will stay the same and still require a review of a franchise/license agreement as it pertains to the applicant.

SBA proposes to retain in §121.301(f)(6) a finding of affiliation based on the totality of circumstances currently found in §121.103(a)(5). This provides SBA with the ability to consider all contributing factors that could potentially impact the determination that the applicant business is small. Therefore, notwithstanding the Agency’s goal to provide bright line eligibility criteria regarding affiliation determinations for loan eligibility, the Agency recognizes that it must prevent instances where large entities participate in a

small business loan program, and application of the totality of circumstances standard will reinforce that program integrity.

SBA proposes to incorporate the exceptions to affiliation set forth in section §121.103(b) in new §121.301(f)(8). SBA does not propose any changes to these exceptions to affiliation.

Finally, SBA proposes to eliminate from the Business Loan Programs several current bases of affiliation that apply in federal contracting. Specifically, SBA proposes to eliminate applying affiliation based on a newly organized concern (see §121.103(g)) and joint ventures (see §121.103(h)). One purpose of the newly organized concern rule is to prevent former small businesses from creating spin-off companies in order to continue to perform on small business contracts or receive other contracting benefits. While this affiliation principle applies in federal contracting, it is generally not applicable to the Business Loan Programs because the responsible party or parties for any loan are the immediate business owners, not any former entity from which they may have been employed previously.

With respect to joint ventures, these partnerships are formed when two or more businesses combine their efforts in order to perform on a federal contract or receive other contract assistance. SBA does not consider this affiliation based on joint venture to be of significant concern to the Business Loan Programs because a loan to any joint venture will require all members of the joint venture to accept full responsibility for loan guarantee liability. Also, agency records indicate that applicants for assistance under SBA Business Loan Programs are rarely, if ever, joint ventures, and, therefore, this provision is unnecessary. For the Surety Bond Guarantee Program, the guarantee is on

the bond, not a contract. Any joint venture project where the applicant small business requests a guarantee would also be subject to guaranteeing the obligation.

SBA also proposes to omit the discussion of “negative control” as a stand-alone factor in determining affiliation for the purpose of loan eligibility. As noted above, pursuant to 13 CFR 121.103(a)(3), negative control may exist where a minority shareholder can block certain actions by the board of directors. Under this proposal for loan eligibility, SBA will consider all factors when making an affiliation determination based on the totality of the circumstances.

SBA considers that this proposed definition of affiliation used in determining the applicant’s loan eligibility, while continuing SBA’s ability to review totality of circumstances, adequately ensures that the loan programs are provided appropriately to small businesses.

#### B. Surety Bond Guarantee Program and Affiliation

Under this program, SBA provides surety bond guarantees for qualified small and emerging businesses, in direct partnership with surety companies. SBA helps small contractors by guaranteeing bid, performance, and payment bonds issued by participating surety companies for contracts up to \$6.5 million so as to allow the qualified small contractor to obtain a contract.

SBA’s SBG Program is most commonly used for non-federal contracts. SBA regularly guarantees bonds for eligible small business on state, local and private entity contracts. State and local jurisdictions may not have the same size and affiliation rules as SBA. SBA has proposed to amend the definition of “Affiliate” in 13 CFR 115.10 to explain that the term is defined in the proposed 13 CFR 121.301 (the loan programs

definition of affiliation).

### C. Request for Comments

SBA requests comments on these proposed amendments to its current regulations. Although SBA seeks comments on all aspects of this proposed rule, it specifically requests comments on the following:

1. What impact will this rule have on Small Business Loan and SBG applicants?
2. Are there alternatives to the proposed rule relating to control, negative control, common ownership, identity of interest, common management, and franchise agreements?
3. Would the elimination of the newly-organized concern and joint venture affiliation rules from the Business Loan and SBG Programs affect those programs, and if so, how?

Compliance with Executive Orders 13563, 12866, 12988, and 13132, the Paperwork Reduction Act (44 U.S.C. Ch. 35,), and the Regulatory Flexibility Act (5 U.S.C. 601–612).

### Executive Order 12866

The Office of Management and Budget (OMB) has determined that this proposed rule is a “significant” regulatory action for the purposes of Executive Order 12866.

Accordingly, the next section contains SBA’s Regulatory Impact Analysis. However, this is not a major rule under the Congressional Review Act, 5 U.S.C. 800.

### Regulatory Impact Analysis

1. Is there a need for this regulatory action?

The Agency believes it needs to reduce regulatory burdens and expand its Business Loan Programs and SBG Program by streamlining delivery, lowering costs, and facilitating job creation. As noted above, responses received from the Federal Register proposed rule notice regarding SBA rules on affiliation were in favor of simplified rules that enhanced understanding and aligned with normal commercial industry practices. Small business applicants will be assisted by this proposed streamlining of requirements because it will be easier and more cost effective for a lender to research whether the applicant small business controls other large companies which would jeopardize their eligibility. Higher lender costs potentially results in greater costs to the applicant small business. What are the potential benefits and costs of this regulatory action?

As stated above, the potential benefits of this proposed rule are based on its elimination of unnecessary cost burdens on loan applicants' and lenders' participation in SBA-guaranteed loans.

These proposed changes would exempt the Business Loan Programs and SBG Program from certain government contracting rules that determine whether an entity is deemed affiliated with an applicant. These general affiliation rules apply to federal contracting to ensure that small businesses (and not another entity) receive and perform a federal contract when a preference for small businesses is provided. Many of these general principles of affiliation (e.g., newly organized concern) are not applicable to the Business Loan Program or SBG Program.

What alternatives have been considered?

As indicated above, on February 25, 2013, the Agency issued a proposed rule for comment in the Federal Register to implement several changes intended to reinvigorate the Business Loan Programs and SBG Program by eliminating unnecessary compliance



burdens and loan eligibility restrictions. Proposed Rule: 504 and 7(a) Loan Programs Updates, 78 FR 12633 (February 25, 2013). Included in these proposals was an alternate affiliation definition. After a full comment period ending April 26, 2013, and careful consideration of all comments, SBA decided to further consider issues of redefining affiliation for the Business Loan Programs and SBG Program. Final Rule: 504 and 7(a) Loan Programs Updates, 78 FR 15641 (March 21, 2014). This proposal presents a set of requirements to determine affiliation based on the precedent separating the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs from the government contracting standards. SBA will review public comment and suggestions to the proposed rule and consider changes needed to mitigate identified economic risk to the taxpayers and reduce waste, fraud, and abuse.

#### Executive Order 13563

A description of the need for this regulatory action and benefits and costs associated with this action, including possible distributional impacts that relate to Executive Order 13563, are included above in the Regulatory Impact Analysis under Executive Order 12866.

With the exception of the Economic Injury Disaster Loan (EIDL) which is a direct loan from SBA to the Borrower, the Business Loan Programs operate through the Agency's lending partners, which are 7(a) Lenders for the 7(a) Loan Program, Intermediaries for the Microloan Program, and CDCs for the 504 Loan Program. The Agency has held public forums and meetings which allowed it to reach hundreds of its lending partners and gain valuable insight, guidance, and suggestions from many of them and the trade associations which represent many of them. The Agency's outreach efforts

to engage stakeholders before proposing this rule was extensive, and will continue throughout the comment period.

#### Executive Order 12988

This action meets applicable standards set forth in Sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have retroactive or preemptive effect.

#### Executive Order 13132

SBA has determined that this proposed rule will not have substantial, direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, for the purposes of Executive Order 13132, SBA has determined that this proposed rule has no federalism implications warranting preparation of a federalism assessment.

#### Paperwork Reduction Act, 44 U.S.C. Ch. 35

The SBA has determined that this proposed rule would not impose significant additional reporting and recordkeeping requirements under the Paperwork Reduction Act (PRA). Specifically, participants in SBA's 7(a) Loan Program will continue to report any affiliates of their business on SBA Form 1919 (OMB Control No. 3245-0348), and participants in SBA's 504 Loan Program will continue to report affiliates on SBA Form 1244 (OMB Control No. 3245-0071). EIDL Program participants will continue to report affiliates on SBA Form 5 (OMB Control No. 3245-0017), and SBG Program participants will continue to report affiliates on SBA Form 994 (OMB Control No. 3245-0007).

Regulatory Flexibility Act, 5 U.S.C. 601-612

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (RFA) requires the agency to “prepare and make available for public comment an initial regulatory analysis” which will “describe the impact of the proposed rule on small entities.” Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities. The rulemaking will positively impact all of the approximately 5,000 7(a) Lenders (some of which are small) and all of the approximately 260 CDCs (all of which are small). The proposed rule will reduce the burden on program participants as they independently choose on what level to participate, with cost to deliver being a significant influence. The proposed modifications of certain program process requirements through this proposed modification of eligibility based on affiliation is not projected to adversely impact or cost on the small business borrower, lender or CDC.

This proposal presents a best practice rule that removes unnecessary regulatory burdens and increases access to capital for small businesses and facilitates American job preservation and creation. SBA has determined that there is no significant impact on a substantial number of small entities. SBA invites comment from members of the public who believe there will be a significant impact either on lenders, CDCs, or their borrowers.

## List of Subjects

### 13 CFR Part 115

Claims, Reporting and recordkeeping requirements, Small businesses, Surety bonds.

### 13 CFR Part 120

Individuals with disabilities, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

### 13 CFR Part 121

Grant programs-business, Individuals with disabilities, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

For the reasons stated in the preamble, SBA proposes to amend 13 CFR parts 115, 120, and 121 as follows:

#### PART 115--SURETY BOND GUARANTEE

1. The authority citation for part 115 continues to read as follows:

Authority: 5 U.S.C. app 3; 15 U.S.C. 687b, 687c, 694a, 694b note; and Pub. L. 110-246, Sec. 12079, 122 Stat. 1651.

2. Amend §115.10 to revise the definition of "Affiliate" to read as follows:

#### § 115.10 Definitions.

Affiliate is defined in §121.301(f) of this chapter.

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#### PART 120 – BUSINESS LOANS

3. The authority citation for part120 continues to read as follows:

Authority: 15 U.S.C. 634(b)(6), (b)(7), (b)(14), (h), and note, 636(a), (h), and (m), 650, 687(f), 696(3), and 697(a) and (e); Pub. L. 111-5, 123 Stat. 115, Pub. L. 111-240, 124 Stat. 2504.

4. Amend §120.1700 to revise the definition of “Affiliate” to read as follows:

§120.1700 Definitions used in subpart J.

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Affiliate. A person or entity SBA determines to be an affiliate of a Program Participant pursuant to the application of the principles and guidelines set forth in §121.301 of this Chapter.

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## PART 121 – SMALL BUSINESS SIZE REGULATIONS

5. The authority citation for part 121 continues to read as follows:

Authority: 15 U.S.C. 632, 634(b)(6), 662, and 694a(9).

6. Amend §121.103 to add paragraph (a)(8) to read as follows:

§121.103 How does SBA determine affiliation?

(a) \*\*\*

(8) For SBA’s Business Loan and Surety Bond Guarantee programs, the size standards and bases for affiliation are set forth in §121.301.

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7. Amend §121.301 to add paragraph (f) to read as follows:

§121.301.What size standards and affiliation principles are applicable to financial assistance programs?

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(f) Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control

both. It does not matter whether control is exercised, so long as the power to control exists. For the purposes of SBA's Business Loan Programs, Disaster Loan Program, and Surety Bond Guarantee Program, the following principles of affiliation apply:

(1) Affiliation based on ownership. For determining affiliation based on equity ownership, a concern is an affiliate of an individual, concern, or entity that owns or has the power to control more than 50 percent of the concern's voting equity. If no individual, concern, or entity is found to control, SBA will deem the Board of Directors or President or Chief Executive Officer (CEO) (or other officers, managing members, or partners who control the management of the concern) to be in control of the concern.

(2) Affiliation arising under stock options, convertible securities, and agreements to merge. (i) In determining size, SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the power to control a concern. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.

(ii) Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered "agreements in principle" and are thus not given present effect.

(iii) Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.

(iv) An individual, concern or other entity that controls one or more other concerns cannot use options, convertible securities, or agreements to appear to terminate such

control before actually doing so. SBA will not give present effect to individuals', concerns' or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation.

(3) Affiliation based on common management. Affiliation arises where the CEO or President of the applicant concern (or other officers, managing members, or partners who control the management of the concern) also controls the management of one or more other concerns. Affiliation also arises where a single individual, concern or entity that controls the Board of Directors or management of one concern also controls the Board of Directors or management of one of more other concerns.

(4) Affiliation based on identity of interest. (i) Affiliation may arise among two or more persons (including any individual, concern, or other entity) with an identity of interest. An individual, concern, or entity may rebut a determination of identity of interest with evidence showing that the interests deemed to be one are in fact separate.

(ii) SBA may presume an identity of interest between close relatives, as defined in 13 CFR 120.10, with identical or substantially identical business or economic interests (such as where the family members operate concerns in the same or similar industry in the same geographic area).

(5) Affiliation based on franchise and license agreements. The restraints imposed on a franchisee or licensee by its franchise or license agreement relating to standardized quality, advertising, accounting format and other similar provisions, generally will not be considered in determining whether the franchisor or licensor is affiliated with an applicant franchisee or licensee provided the applicant franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership.

Affiliation may arise however, through other means, such as common ownership, common management or excessive restrictions upon the sale of the franchise interest.

(6) Affiliation based on SBA's determination of the totality of the circumstances. SBA may find affiliation after considering the totality of the circumstances, even when no single factor is sufficient to constitute affiliation.

(7) Determining the concern's size. In determining the concern's size, SBA counts the receipts, employees, or the alternate size standard of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.

(8) Exceptions to affiliation. For exceptions to affiliation, see 13 CFR 121.103(b).

Maria Contreras-Sweet,  
Administrator.

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